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Report Highlights:

Following a rise in CY2002, UK production of cigarettes is forecast to fall slightly to 130 billion pieces in CY2003. Over a half of these are expected to be exported. Around a third of the UK's adult population, or 15 million people, smoke with a total annual duty-paid expenditure of around USD20 billion. However, it is widely accepted that true expenditure on tobacco products is significantly higher than this figure due to the importance of the non-duty paid sector. In a parallel development, while filter cigarette consumption appears to be in steady decline, increasing numbers of consumers are switching, in whole or in part, to RYO cigarettes thereby countering this apparent overall downward trend in cigarette consumption.

Includes PSD changes: Yes
Includes Trade Matrix: Yes
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Explanatory Notes

Stocks

The format of the production, supply and demand (PSD) tables for cigarettes featured in this report makes no allowances for stocks. The trade information is, therefore, distorted when it is reported in the PSD and in turn affects the supply and distribution totals. To remedy this problem the actual market conditions are described in separate tables within the body of the text. References to market data therefore relate to these tables and not the traditional PSD tables which for cigarettes can be found in the statistical appendix.

Exchange Rates

This report refers to sterling's competitiveness against other currencies. The following table provides yearly average exchange rates for sterling against the U.S. dollar and the Euro. The latter currency replaced the European Currency Unit (ECU) on 1 January, 1999 and entered full circulation in the participating European countries on 1 January, 2002.

From 1996 through 1999 sterling appreciated in value relative to the Euro and the U.S. dollar. Following a three year period during which sterling's value against the dollar steadily declined, 2002 through to the present have once again seen sterling rising back towards its 1999 dollar rate. However, on the EU market the Euro, which lost considerable value against sterling in 2000, has been showing increasing strength in recent times and, at the time of writing, has reached a record high against sterling.

EXCHANGE RATES		
Year	Euro per BPS	USD per BPS
1995	1.2070	1.5785
1996	1.2286	1.5610
1997	1.4431	1.6393
1998	1.4789	1.6570
1999	1.5192 (1)	1.6179
2000	1.6419	1.516
2001	1.6084	1.4405
2002	1.59087	1.4995
2003 (2)	1.48166	1.5963
06-May-03	1.4242	1.606
(1) Euro superceded ECU from January 1, 1999		
(2) January - April 2003 average		
Source: Bank of England		

Note: Throughout this report the rate of exchange used is BPS 1 = USD 1.6

Executive Summary

The UK tobacco industry is dominated by three national companies – Gallaher Ltd, Imperial Tobacco Ltd and British American Tobacco (BAT), the latter operating as Rothmans (UK) Ltd. All three predominantly produce cigarettes but also manufacture hand rolling and pipe tobaccos and cigars for the UK and export market.

This report focuses on unmanufactured tobacco and cigarettes, the two most important elements in the UK tobacco market. Although the UK imports all of its tobacco leaf, it is a substantial exporter of finished tobacco products, mainly cigarettes, to the Far and Middle East and Eastern Europe. In CY2002, the UK tobacco export market was worth around BPS920 million (USD1.47 billion), little changed on CY2001 as the UK continues to struggle to recoup export volumes lost following the economic downturn in the Far East in the late 1990s. A small rise in domestic consumption of duty-paid cigarettes in CY2002 encouraged increased production that year but this is not expected to be long lived and the overall long-term decline in domestic duty-paid consumption volumes is forecast to continue, keeping the sector under considerable pressure. Despite this, hopes remain that the UK's main export markets are showing some signs of recovery and, as such, producers are forecast to only lower production to 130 billion pieces in CY2003.

There are currently some 15 million adult smokers in the UK, about a third of the adult population. Total duty-paid consumer expenditure on tobacco products was more than BPS12.5 (USD20) billion in CY2002, this being spent on 56 billion cigarettes, 2,805 tons of hand rolling tobacco and 872 million cigars. However, it is widely accepted that these figures mask the true total UK expenditure on, and consumption of, tobacco products as many consumers turn to personal or black market non-duty paid imports. For example, in the ten years since the European Single Market was formed in 1993, and cross-channel trade began in earnest, officially reported UK cigarette sales to the trade have declined 39 percent. That said, over the same ten years, cigarette consumption has declined just 15 percent to around 76 billion pieces in CY2002, the non-duty paid consumption of cigarettes having increased from just 3.5 billion pieces in CY1993 to an estimated 20 billion pieces in CY2002. Further, once hand rolled tobacco is included cigarette consumption is virtually unchanged.

UK taxes on tobacco products generated almost BPS10 (USD16) billion in CY2002, equivalent to around 4 cents in the dollar on the basic national rate of income tax. With the highest incidence of tobacco tax in the EU, the tax (excise duty plus value added tax) currently accounts for just under 79 percent of the price of the leading brand of cigarettes in the UK. This compares with beer at 29 percent, wine at 51 percent, spirits at 61 percent and unleaded petrol at 75 percent. Consequently, UK tobacco prices are among the highest in the world. Although the average pack of 20 cigarettes in the UK can cost over three times as much in other EU countries such as Spain, it is the difference on hand-rolled (RYO) tobacco that is most marked, with popular brands costing between four and five times more in the UK than they do in Belgium. As such, it is unsurprising that UK Customs estimate that 21 percent of the cigarettes smoked in the UK in CY2002 were bootlegged or smuggled while a further 7 percent were legally purchased overseas. It is also unsurprising that the RYO market has more than doubled in the past ten years and continues to show strong growth, particularly when the UK's Tobacco Manufacturers Association estimates that 70 percent of that market is non-duty paid.

While government initiatives to stop smuggling may curb the illegal imports somewhat, legitimate trade in non-duty paid tobacco will continue, if not increase, as long as the tobacco price differentials between the UK and other EU countries remain. Government anti-smoking initiatives may eventually reduce domestic consumption but these figures are not expected to decline by much in the near future.

Unmanufactured Tobacco

PSD Table

Country	United Kingdom					
Commodity	Tobacco, Unmfg., Total				(HA)(MT)	
	2001	Revised	2002	Estimate	2003	Forecast
	USDA Official[Old]	Post Estimate[New]	USDA Official[Old]	Post Estimate[New]	USDA Official[Old]	Post Estimate[New]
Market Year Begin		01/2001		01/2002		01/2003
Area Planted	0	0	0	0	0	0
Beginning Stocks	22398	22398	14554	20577	22304	16928
Farm Sales Weight Prod	0	0	0	0	0	0
Dry Weight Production	0	0	0	0	0	0
U.S. Leaf Imports	1206	1390	4000	4265	0	4000
Other Foreign Imports	101460	101237	115000	100376	0	105000
TOTAL Imports	102666	102627	119000	104641	0	109000
TOTAL SUPPLY	125064	125025	133554	125218	22304	125928
Exports	10510	10563	10500	13090	0	11000
Dom. Leaf Consumption	0	0	0	0	0	0
U.S. Leaf Dom. Consum.	1000	1135	3750	4000	0	3750
Other Foreign Consump.	99000	92750	97000	91200	0	90500
TOTAL Dom. Consumption	100000	93885	100750	95200	0	94250
TOTAL Disappearance	110510	104448	111250	108290	0	105250
Ending Stocks	14554	20577	22304	16928	0	20678
TOTAL DISTRIBUTION	125064	125025	133554	125218	0	125928

UK imports of unmanufactured tobacco continued to fall in CY2002 but to a lesser extent than in previous years. Brazil and Zimbabwe remain the two key suppliers to the UK although CY2002 did see a large rise in imports from China. India, the U.S. and Italy (most of the latter's leaf being transhipped product from Sri Lanka and India) complete the top six who together accounted for almost 75 percent of the total volume that year. Available data would indicate that stocks are becoming increasingly depleted. As such, CY2003 is forecast to see some recovery in import demand.

UK exports of unmanufactured tobacco are small, generally remaining between 10,000 and 11,000 tons, although CY2002 did see just over 13,000 tons exported. The traditional markets remain France and Ireland who together accounted for over 55 percent of the total in CY2002. Little change is forecast for CY2003.

Revisions to historical data suggest that UK consumption of tobacco leaf has steadied at around 94,000 tons, reflecting the stabilizing of cigarette production in the UK. However, this figure is somewhat dependent on assumptions on stocks. With cigarette production forecast little changed in CY2003 and imports currently

forecast to rise, some build up in stocks from their current very low level is foreseen.

Trade Matrices

Import Trade Matrix			
Country	United Kingdom		
Commodity	Tobacco, Unmfg., Total		
Time period	Jan - Dec	Units:	MT
Imports for:	2001		2002
U.S.	1390	U.S.	4265
Others		Others	
Brazil	45226	Brazil	33347
Zimbabwe	19608	Zimbabwe	19501
Italy	4250	China	8922
India	3833	India	6164
Belgium Lux	3642	Italy	4234
Canada	3201	Belgium Lux	3123
Spain	3003	Uganda	2937
Tanzania	2752	Spain	2743
China	1894	Canada	2661
Uganda	1814	Argentina	2581
Total for Others	89223		86213
Others not Listed	12014		14163
Grand Total	102627		104641

Export Trade Matrix			
Country	United Kingdom		
Commodity	Tobacco, Unmfg., Total		
Time period	Jan-Dec	Units:	MT
Exports for:	2001		2002
U.S.	17	U.S.	1
Others		Others	
France	4059	France	3865
Ireland	3774	Ireland	3390
Singapore	576	Singapore	1217
Bangladesh	521	Bangladesh	1155
Cambodia	271	Kazakhstan	941
Netherlands	225	Austria	426
Kazakhstan	218	Spain	340
Greece	203	Ukraine	304
Rwanda	137	Germany	193
Ghana	101	Latvia	182
Total for Others	10085		12013
Others not Listed	461		1076
Grand Total	10563		13090

Cigarettes

	1999	2000	2001	2002	2003
Opening stocks	273597	277939	315435	532192	547265
Production	134568	126105	126141	133014	130000
Imports	25041	71801	246584	10428	15000
Exports	92267	104110	100468	72369	636765 (1)
Duty-paid consumption	63000	56300	55500	56000	55500
Private/Illegal Imports	21000	25200	23500	20000	18500
Total consumption	84000	81500	79000	76000	74000
Closing stocks	277939	315435	532192	547265	0
(1) Total available to export/re-export during 2003					

Production

UK cigarette production is estimated at 133 billion pieces in CY2002. This is an increase on CY2001, trade sources partially citing increased clearances (cigarettes cleared for home consumption and therefore liable for excise duties) and improved duty-paid sales. However, this rise is not forecast to be maintained in CY2003, production forecast to fall slightly to 130 billion pieces.

Consumption

The UK cigarette market continues to be characterized by down trading of one form or another. As the price of duty-paid cigarettes has risen, such that a twenty packet of a premium brand now costs around BPS4.60 (USD7.35), cigarette smokers have unsurprisingly looked for alternatives.

As highlighted in previous reports, some have turned to purchasing smaller packets, an area of the market which continues to show good growth, but others are taking more drastic measures such as seeking out alternatives to their usual brands or switching away from filter cigarettes altogether. While for many this has meant down trading from premium to middle-priced brands before the almost inevitable move to an economy or ultra-low price brand, for others a switch to RYO has been the answer. As such, while cigarette consumption appears to be in downward decline, falling from 79 billion pieces in CY2001 to an estimated 76 billion pieces in CY2002 and forecast to fall to 74 billion pieces in CY2003, consumption of RYO (be it consumers switching totally or becoming cigarette/RYO dualists) has risen such that 'true' cigarette consumption (including RYO at a cigarette equivalent of 0.4g per cigarette) appears to be much more stable, albeit in slight decline.

'True' Cigarette Consumption (billion pieces)

	Cigarettes	Cigarette Equivalent of RYO	True' Cigarette Consumption
1993	89	11	99
1994	88	11	99
1995	88	13	101
1996	87	15	102
1997	84	16	101
1998	84	19	103
1999	84	21	105
2000	82	24	105
2001	79	24	103
2002	76	25	101

Source: Tobacco Manufacturers Association

On filter cigarettes, the major companies have reacted to consumer demand for cheaper cigarettes by launching their own economy brands which have subsequently proved very successful. Gallaher has added to its successful "value-for-money" Mayfair brand by introducing Mayfair Superkings while Imperial's Richmond brand continues to go from strength to strength. Introduced three years ago, this latter brand now generates over BPS1 (USD1.6) billion in sales alone. According to industry estimates, the lower priced sector now accounts for more than 50 percent of the total duty-paid market and all expectations are that it will continue to show good growth at the expense of the premium brands.

For the many consumers who trade down even further to non-duty paid cigarettes, these can be either legally imported or, more likely, otherwise. On the black market, premium brands cost little more than half the price of the legal equivalent and around BPS1 (USD1.6) lower than the cost of the lowest ultra-low price brand. In CY2002, it is estimated that of the total 76 billion cigarettes smoked in the UK, 20 billion were non-duty paid of which three quarters were illegally smuggled into the UK with the remainder being legitimate cross border, duty-free purchases. That said, this was a reduced figure as compared with the 23.5 billion non-duty paid cigarettes reportedly consumed in the UK in CY2001. This is surely due, in part, to the increased resources UK Customs is focusing on this area. However, a recent court case in the UK in favor of a company against UK Customs and its policy of vehicle seizure for unpaid duty, followed by a change in the indicative level to 3,200 cigarettes or 3kg of RYO tobacco, could increase the penetration of legal non-duty paid EU product in CY2003 as more legitimate cross-channel shoppers exercise their freedoms. It may also make small scale smugglers more difficult to identify.

As noted previously, but worth noting again, those who trade down to hand rolled tobacco will likely be smoking smuggled goods - around 70 percent of the RYO market is allegedly accounted for by illegal imports.

Top 10 best selling cigarettes in UK multiple grocers

Lambert & Butler King Size	Imperial
Benson & Hedges King Size	Gallaher
Mayfair King Size	Gallaher
Superkings	Imperial
Marlboro Lights	Imperial
Silk Cut King Size	Gallaher
Richmond Superkings	Imperial
Rothmans Royals King Size	Rothmans (UK)
Lambert & Butler Gold	Imperial
Richmond King Size	Imperial

Source: RAL January 2003

Trade

Most UK duty-paid consumer demand is met by domestic production. Indeed, the UK maintains a positive trade balance in the cigarette market, exporting over a half of all production. It is also currently holding substantial stocks. The most important export markets for the UK in value terms are Germany and Spain in the EU, Singapore, Hong Kong and South Korea in the Far East and Saudi Arabia in the Middle East. While CY2002 saw a further decline in exports, most traders remain positive regarding CY2003 trade.

Nearly all of the UK's recorded cigarette imports come from other EU countries with Germany accounting for nearly 60 percent of the CY2002 total of just over 10 billion pieces. The key third country supplier in CY2002 was the U.S. which accounted for 17 percent. In addition to the legal imports, and as highlighted previously, it is estimated that a further 20 billion cigarettes entered the country as personal or illegal imports in CY2002. CY2003 is expected to see a reduction in the smuggled and duty-paid imports while personal imports will remain steady, if not rise marginally, for the reasons alluded to previously.

Trade Matrices

Import Trade Matrix			
Country	United Kingdom		
Commodity	Tobacco, Mfg., Cigarettes		
Time period	Jan-Dec	Units:	MT
Imports for:	2001		2002
U.S.	502	U.S.	1750
Others		Others	
Germany	235060	Germany	6056
Netherlands	6911	Portugal	801
Belgium Lux	3599	Netherlands	700
Ireland	217	Belgium Lux	418
Austria	125	Ireland	226
France	47	Austria	194
Hong Kong	22	Singapore	143
Gambia	18	Denmark	78
Somalia	17	Switzerland	22
Switzerland	15	Greece	9
Total for Others	246031		8647
Others not Listed	51		31
Grand Total	246584		10428

Export Trade Matrix			
Country	United Kingdom		
Commodity	Tobacco, Mfg., Cigarettes		
Time period	Jan-Dec	Units:	MT
Exports for:	2001		2002
U.S.	1105	U.S.	953
Others		Others	
France	10313	South Korea	10916
Singapore	9981	Nigeria	5011
Russia	8997	Hong Kong	4592
Spain	6625	Spain	4141
South Korea	5949	Singapore	3651
Netherlands	5932	Saudi Arabia	3639
Hong Kong	5030	Netherlands	3140
Nigeria	4298	Germany	3121
Saudi Arabia	3604	UAE	2778
Ghana	3541	Benin	2457
Total for Others	64270		43446
Others not Listed	35093		27970
Grand Total	100468		72369

Policy Issues

Tax Policy and Prices

UK government policy towards tobacco taxes has remained largely unchanged since the Conservative government introduced the so-called escalator tax in the early 1990s, with the publicised aims of reducing consumption (particularly in children under the age of sixteen), thereby reducing the burden on the national health service of smoking-related diseases, and increasing revenue. The Labour administration, which took power in 1997 and was re-elected in 2001, has continued this policy with above inflation annual increases on tobacco taxes effectively becoming the norm. As such, the UK tobacco sector is one of the most heavily taxed in the world, and UK cigarette prices are the highest in the EU, with taxes accounting for around 84.5 percent of the retail cost of a typical packet of cigarettes. With prices approximately double those in nearby France, Belgium and the Netherlands, smuggling is a major problem.

Most Popular Price Category Cigarette across the EU (April 2003)
(Package of 20)

	Retail Price	VAT	Ad Valorem	Specific	Total Tax	Tax Incidence
UK	451	67	99	188	355	78.7
Ireland	401	70	74	173	316	78.8
Denmark	312	62	66	113	241	77.4
Finland	276	50	138	21	209	75.6
France	269	46	149	10	205	76
Sweden	281	56	110	30	196	69.9
Germany	233	32	56	85	174	74.7
Belgium	227	39	104	26	169	74.6
Austria	207	35	87	30	151	72.9
Netherlands	202	32	41	74	147	73
Greece	183	28	99	6	133	72.5
Italy	173	29	94	6	128	74.2
Luxembourg	171	18	80	16	115	67.1
Portugal	145	23	33	56	113	77.7
Spain	135	19	73	5	97	71.8

Source: Tobacco Manufacturers Association

Smuggling – Anti Smuggling Initiatives

The UK government estimates MY2001 revenue losses at BPS4.4 (USD7) billion split between BPS1.1 (USD1.75) billion in legitimate cross border purchases and BPS3.3 (USD5.25) billion in smuggled tobacco products. These figures take into account the value of excise duty and Value Added Tax (VAT). Estimates suggest that over a quarter of all cigarettes sold in the UK in CY2002 were non-duty paid. Much has been made

of the losses to the retail trade as a result of smuggling.

According to industry sources, without a change in UK tax policy, the non-duty paid sector will remain a significant one. The industry argues that as the price of cigarettes has risen, criminals, using distribution channels established for the illegal sale of RYO have increasingly turned their attention to smuggling cigarettes. This has a much larger impact on excise revenues. The National Crime Intelligence Service has also suggested that the high profits and relatively low risks and penalties compared with other forms of serious and organised crime, such as drug trafficking, have exacerbated the problem. The trade also argues that illegal cigarettes and other tobacco products are so widely available that it is reducing the effectiveness of UK tax policy in curbing smoking and leading to higher and unregulated consumption than would otherwise be expected, sales to children being cited as a particularly emotive example.

Despite a Tackling Tobacco Smuggling Strategy, UK Customs only expect to reduce the level of smuggling to 18 percent by 2004/5. Additionally, of course, this does nothing to stem the flow of legitimate cross border purchases.

Anti-smoking initiatives

The UK government has made reducing the incidence of smoking a key health objective. In addition to its policy of high taxes, it has supported wholeheartedly various EU directives to curb smoking.

The introduction of the EU tobacco directive has brought changes to all tobacco packaging manufactured for sale in the UK, and in some cases changed the product itself. All tobacco packaging must carry larger, clearer health warnings, which vary in size depending on the product. As an example, for cigarettes the front face of the packaging must incorporate a health warning covering no less than 30 percent of the surface area, while the rear of the pack must feature a health warning covering no less than 40 percent of the area, with both surrounded by a 3mm black border. Another part of the directive bans the use of terms such as Lights, Mild and Ultra and to accommodate this manufacturers are making changes to the names of some brands. Imperial Tobacco, for example, is utilising colours to represent brand variants such as Lambert & Butler Gold (formerly Lights) and Embassy Blue (formerly Mild). From 1 January, 2004, tobacco products will no longer be allowed to exceed 10mg tar, 1mg nicotine and 10mg carbon dioxide and yield levels must be identified on the side of the packs, surrounded by a 3mm black border.

Also, in the UK specifically, after an initial failed attempt, the Government's Tobacco Advertising and Promotion Act became law in November 2002. Subsequently, press and poster advertising was banned from 14 February 2003, direct marketing and in-pack promotion schemes will be banned from 14 May 2003 and sponsorship of national events will be banned from July 2003 and of global events from 31 July 2005. Regulations on point of sale and brand sharing are still awaited at the time of writing. Finally, in line with the changes to health warnings, the UK DUTY PAID mark carried on tobacco products will also change to black on white, again surrounded by a 3mm black border.

The UK also has a number of voluntary agreements on tobacco advertising and promotion but many of these will cease to apply as they become superseded by the legislation.

Other Products

Roll Your Own (RYO)

The RYO market is the second most important tobacco market in the UK with around 5.5 million regular smokers and around 1 million dualists (those who smoke RYO and cigarettes). In recent years its popularity has grown as the cost of duty-paid cigarettes has continued to rise. Much of this consumption is of non-duty paid goods, unofficial estimates suggesting that of the total 10,000 tons consumed in CY2002, just 2,800 tons were duty-paid, the vast majority of the remainder having been illegally smuggled into the UK. Further, as an area that traditionally attracted an older clientele, it is interesting to note that it is becoming increasingly popular among young smokers. This becomes even more interesting given that market research indicates that once smokers have switched to RYO they are unlikely to switch back to cigarettes.

The major companies have reacted to the development of the RYO sector by introducing a number of innovative accessories from new style lighters to rolling machines to various colour coordinated RYO products. The rolling paper sector alone is currently estimated to be worth BPS100 (USD160) million.

As long as UK cigarette taxes remain high, the RYO market and its accessory sector is expected to continue to show good growth.

Top RYO tobacco brands in multiple grocers in the UK

Golden Virginia
Amber Leaf
Drum
Old Holborn
Cutters Choice
Samson
Drum Gold

Source: RAL, January 2003

Cigars

The UK cigar market is worth approximately BPS500 (USD750) million, with consumption in CY2002 totalling approximately 900 million cigars. Overall cigar consumption has been in slow decline for a number of years in the UK. However, within the sector, small or miniature cigars continue to flourish at the expense of standard and large cigars to the extent that five of the top ten brands in the sector are now of this variety. By CY2004 many expect small cigars to account for over 50 percent of all cigar sales with increasing numbers of cigarette smokers partaking in the occasional small cigar. Indeed, such is the success of small cigars that the cigar sector overall continues to see growth in value terms despite the fall in volume purchases.

Overall top 10 cigars in UK multiple grocers

	Miniature
Hamlet	
Hamlet Miniatures	*
HW Café Creme Blue	*
Classic	
HW Café Creme	*
Panama	
King Edward Coronets	
King Six	
Ritmeester R/D miniatures	*
Small Classic Filter	*

Source: RAL, January 2003

Pipe Tobacco

The pipe tobacco sector remains in decline, down another 10 percent on CY2002. With around 400,000 pipe smokers in the UK consuming between 600-675 MT of tobacco in CY2002, the market is estimated to be worth around BPS75 (USD120) million. As a niche market, characterised by older smokers, the market is expected to continue to shrink.

Top-selling pipe tobacco brands in UK multiple grocers

St Bruno Ready Rubbed
Condor Ready Rubbed
Clan Mixture
Benson & Hedges Mellow Virginia Ready Rubbed
Gold Block
St Bruno Flake

Source: RAL, January 2003

Appendix

Cigarettes PSD

PSD Table						
Country	United Kingdom					
Commodity	Tobacco, Mfg., Cigarettes				(MIL PCS)	
	2001	Revised	2002	Estimate	2003	Forecast
	USDA Official[Old]	Post Estimate[New]	USDA Official[Old]	Post Estimate[New]	USDA Official[Old]	Post Estimate[New]
Market Year Begin		01/2001		01/2002		01/2003
Filter Production	125891	125891	125750	132764	0	129750
Non-Filter Production	250	250	250	250	0	250
TOTAL Production	126141	126141	126000	133014	0	130000
Imports	58189	53327	60000	15355	0	44000
TOTAL SUPPLY	184330	179468	186000	148369	0	174000
Exports	100607	100468	102000	72369	0	100000
Domestic Consumption	83723	79000	84000	76000	0	74000
TOTAL DISTRIBUTION	184330	179468	186000	148369	0	174000